I am delighted to be here and would like to thank Chatham House and Alex Vines for having brought together such an impressive group to discuss the timely topic of SWFs in Africa. The IMF recently conducted an in-depth study of the state of resource-rich developing countries to a peer group not so favorably endowed. As the so-called oil curse is well known, you will not be surprised that the resource rich countries were generally worse off by a number of indicators—from per capita incomes to miles of paved roads. What may be more surprising, however, is that the gap between the two groups closed significantly over the last decade compared to the previous twenty years. A reason for this improved performance may be strengthening of the governance of natural resources through sovereign wealth funds, not least because of the positive example and technical assistance provided by several successful and established funds.

I have been asked to speak to the Santiago Principles and their relevance to SWFs in Africa. I would like to briefly preface my remarks with a bit of history on the elaboration of the Santiago Principles, what they are and what they are not.

Oddly enough, the genesis of the Santiago Principles lay with the US Treasury. In 2006, the US administration was surprised when the US Congress tried to block Dubai Ports World, from buying US port operations. Shortly afterwards, the newly created Chinese Investment Corp made its first investment, buying interests in a large US private equity firm. The debut of CIC onto the marketplace led to a near public hysteria over foreign government-owned investment vehicles. Pundits predicted that these funds would grow from $2 to over some $12 trillion and their lack of transparency fueled imaginations. Governments in the West started to discuss legislation to block inward investment by foreign government funds. The US Treasury perceived that there was a mutual interest in calming down the sound and fury by encouraging the established sovereign wealth funds to agree to a set of operating principles based on:

- good governance,
- independence from political interference
- commercial objectives
- accountability, and
- free flows of international capital
Over the next two years, twenty SWFS met regularly to hammer out issues with external stakeholders including the IMF, the World Bank, the OECD and recipient governments. While often contentious, these meetings afforded a sharing of perspectives and brought tremendous expertise to the table. In 2008, in Santiago, Chile, 24 countries agreed to seek to conduct their operations based on the 24 principles that became known as the “Santiago Principles” in honor of the country hosting the meeting. These principles are not law, not a treaty, not regulation, nor are they a compliance document. They are simply a voluntary agreement on a set of principles to inform domestic legislation, regulation and operating policies and practices. It is an aspirational document as the signatories commit to work towards bringing their operations in line with the principles with periodic review on progress.

How do these principles relate to resource rich countries in Africa? First, many oil funds have a checkered past and have failed in both preserving national wealth and fostering balanced growth. As a relative newcomer to the game, Africa can benefit from the collective experience and best practices of SWFs from the Middle East, Europe, North America, Asia and Botswana, which have been distilled in the Santiago principles. New resource-rich countries in Africa have an opportunity to break from the oil curse by setting up transparent, resilient and effective institutions to manage national wealth. Observance of the principles, moreover, enhances domestic and global confidence in the SWF, facilitating outbound investment and establishment of commercial counterpart relationships.

For resource-rich countries, the Santiago Principles are based on a rule-based, transparent regime for dividing commodity-based revenues between the budget and an investment portfolio. The principles are explicit in separating the roles of the owner of the funds—the government acting as fiduciary for the people—and the investment management of the funds, which is the responsibility of the SWF. In resource rich countries, the role of the SWF would be

- to preserve net wealth in real terms over a specified investment horizon,
- to provide liquidity for the current budget and,
- for funds with longer horizons, to generate investment income to maintain government spending levels over time.

Under the Principles, the SWF is accountable to the government for its results but should operate independently and free from political influence.

I would like to focus my remarks on several challenges facing SWFs in Africa in observing the principles, particularly with respect to a trend towards inward rather than foreign investment and also with respect to running an asset management operation.
As sovereign wealth funds develop in Africa, the challenge is to balance the need for domestic investment with the diversification of income afforded by global portfolio investment. It is clear that African countries need to invest in infrastructure and human capital to promote balanced economic growth. While the IMF is adamant that such spending and investment be carried out through the government budgetary process and not directly by the SWF, the Principles are more nuanced on this point. They simply state that investments should be made based on financial, commercial and economic criteria and do not differentiate between domestic and international investments.

For SWFs in Africa that contemplate investing domestically, the difficulty in observing this principle is minimizing the risk that the investment process from being captured by political elites. Historically, the financial results of direct, domestic investment by both development banks and SWFs are poor. As an example, both the Alberta Heritage Fund and the Trinidad and Tobago government first experimented with inward investment for development purposes. Neither effort was successful on multiple counts, creating public support for restructuring the funds to allow them only to invest overseas. While New Zealand allows its Superannuation Fund to invest in some domestic projects, a doubly reinforced governance structure has been put in place to ensure that any domestic investment is done on an arms-length basis and free from political influence. This may be more difficult in some African countries characterized by weak institutions and separation of powers. It should be noted, however, that a couple SWFs in Africa are attempting to avoid this risk through investing via private equity funds as a limited partner rather than through direct investment.

A second pitfall from domestic investment arises from concentration of risks. The Principles state that the investment objectives of the SWF are to be based on "maximizing risk-adjusted returns". To achieve this, requires risk diversification. Investment in domestic projects tends to concentrate risk as domestic economic growth is generally highly correlated with export prices. During commodity boom times, revenues flow into the fund and domestic investments tend to do well. But, during bust times, the reverse holds true. Investing globally diversifies income and can lower the volatility of government revenues—a contributing factor to the oil curse.

A final challenge in observing the Principles relates to building asset management capacity. Principles 18 to 23 cover the institutional building blocks of running an asset management organization, including development of investment policy, specification of risk/return objectives, articulation of investment strategies, risk management and, performance measurement based on investment benchmarks and exercise of proxy rights.

Based on my professional experience, I can attest to the difficulty of building such an operation in any public-sector setting but even more so in emerging market countries. Nationals with investment management skills will be bid up in the
international marketplace and official sector institutions may not be able to compete even for local talent. Moreover, global portfolio management is data intensive and requires expensive systems that typically need to be customized. In my experience working with African central banks, such systems often remain underdeveloped, underutilized or rust because of poor support from the vendor or lack of specialized IT skills. In this regard, Africa countries subscribing to the Principles can benefit from membership in the International Sovereign Wealth Fund Forum, which is committed to knowledge sharing and mutual support amongst its members.

I will close my remarks by noting that currently five SWFs in Africa—Botswana, Libya, Equatorial Guinea, Angola and Nigeria—have subscribed to observance of the Santiago Principles and have joined the ISWF—with Nigeria and Angola joining this past summer.

With this, I will pass the mike to my fellow panelist and look forward to a lively exchange of ideas following the panel.